American Property Casualty Insurance Association
INSURING AMERICA apci.org

COVID-19 Impact on Businesses, Insurers, and the Economy

Overview

With the United States now surpassing all other countries in the number of reported COVID-19 cases and deaths, few anticipated the pace at which the U.S. economy would shut down and that physical distancing would become so pervasive. As an essential service, the home, auto, and business insurance industry has transformed into a largely remote workforce in an extremely short time-period to continue fulfilling our promises to policyholders. Insurers quickly began voluntarily paying out tens of billions of premium dollars through refunds and claims payments to our customers. Total COVID-19-related loss payments by insurers are expected to be near or exceed the greatest insured loss events in U.S. history, while insurers have already suffered record losses to their surplus. However, despite the exacerbating loss exposures, insurers expect to be able to fulfill current commitments to policyholders so long as the states or the federal government do not destabilize the industry by enacting or retroactively rewriting insurance contracts and imposing ruinous coverage requirements that were never underwritten or priced.

The property casualty industry's surplus is estimated to have declined over $80 billion from the end of 2019 to the end of 2020 Q1. The remaining surplus is currently committed to and leveraged across the U.S. economy to support roughly $100 trillion in risk exposure and economic activity at a ratio of 1:125[i]. If insurers' surplus were to suddenly and significantly decline further there would be a much more severe contraction in overall commercial activity as businesses would not be able to obtain adequate protection to rehire workers and reopen.

To understand the magnitude of the problem and why traditional property casualty insurance cannot be the answer, you need to look at all aspects of the issue through not just the insurance lens, but also at the potential impact a market failure of such a cornerstone of the U.S. economy (and indeed worldwide) could have on our recovery. This paper provides a practical view of these concerns and potential impact and examines some potential solutions to address these types of events in the U.S. moving forward.

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Viral Outbreaks Are Uninsurable Risks

While insurers are paying for claims that are covered by insurance policies, most insurance policies do not include coverage for viral risks. That is because widespread viral outbreaks are not insurable risks. There have been seven viruses in the last 18 years causing multi-billion-dollar losses, five of which caused damages nearly as high or exceeding Hurricane Katrina (which was the most expensive insured loss event in U.S. history).[ii] COVID-19 is expected to cause $9 trillion in global losses.[iii] One month's estimated business continuity losses related to COVID-19 for all U.S. businesses could potentially exceed the entire U.S. property casualty insurance industry surplus.[iv] Viral outbreaks are too widespread, severe, and unpredictable to underwrite, which is why the vast majority of commercial property insurance policies do not provide coverage for losses related to viruses or other communicable diseases. Few insurers have offered such coverage, and very few consumers have purchased it.

COVID-19's impact on U.S. property casualty insurers includes expected (non-business interruption) insured losses of $40-80 billion[v] and an $87 billion property casualty surplus loss from market declines.[vi]

In other words, COVID-19 related losses for insurers are already expected to far exceed insured losses for Hurricane Katrina and 9/11 combined, before any consideration of state and federal proposals for retroactive coverage. Insurer revenues traditionally have correlated directly with changes in the U.S. GDP and dropped significantly in the first quarter. However, they have leveled out in the second quarter, but 2020 marked the first time in at least 40 years that the Moody's Seasoned Baa Corporate Bond Yield fell below 4%, while the 5-year Treasury bond rate slid to a similarly unprecedented 0.3% in July. The property casualty industry holds a significant amount of municipal, state and Treasury bonds, thus the industry's investment income will no doubt be depressed. While a small number of insurers have made some limited viral coverage available in limited situations, the number of businesses purchasing the product have been exceedingly low. The private market risk of loss due to a pandemic such as COVID-19 is not estimable due to the severity, frequency, return period, and government decisions – all of which cannot be sufficiently modeled, especially when you consider the potential impact of other events that could occur (and in fact have) at the same time (e.g., stock and bond market downturn, unemployment, a potential natural or man-made catastrophe such as Hurricane Laura). Even if it were possible to actuarially price viral coverage, businesses would likely not purchase it as the protection would be extremely expensive. Such a product would need to be extensively subsidized by the government to encourage an adequate number of businesses to purchase the product and to create an adequate spread of risk.

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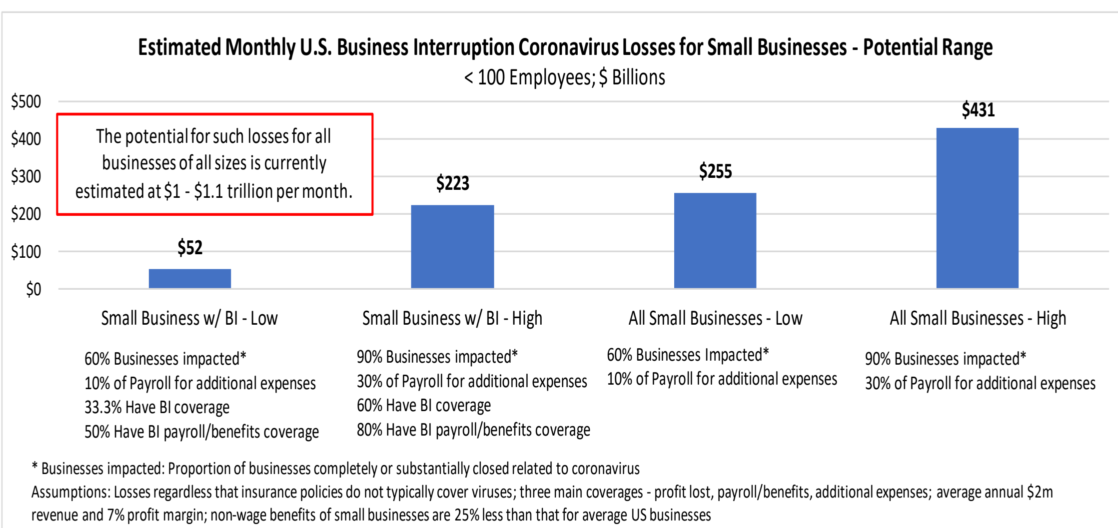
APCIA estimates that coverage for viral outbreaks would add tens of billions of dollars in annual premium costs for a business interruption coverage that a majority of small and mid-sized businesses already find too expensive to buy (even when it doesn't cover viral risks.) Viral outbreak risks are uninsurable because insurers do not have the balance sheet to provide a meaningful supply of coverage, while consumers have been unwilling to provide meaningful demand at market rates.

Business Continuity Losses

APCIA currently estimates that COVID-19 losses suffered by American small businesses (fewer than 100 employees) are in the range of $52-$223 billion per month for the segment of businesses *that have some insurance coverage* for business interruption (BI). However, the business interruption coverage purchased by such businesses typically does not cover losses related to viruses. The estimate for the impact on *all* small businesses with fewer than 100 employees (*whether they have some BI insurance coverage or not*) is $255-$431 billion per month.

The current total property casualty industry capital and surplus is approximately $800 billion. Thus, were the business losses described above in the current crisis allowed to fall on the U.S. property casualty insurance industry, those losses would entirely wipe out the industry's capital and surplus for all lines of business in a matter of a few months, making the segment financially unviable – and this only accounts for losses of *small* businesses with fewer than 100 employees, not all small businesses, nor *all* businesses.

The potential for BI-type coverage losses for *all businesses of all sizes*, with or without BI coverage, is currently estimated at $1-$1.1 trillion per month. ***Thus, total business interruption losses in just a single month would exceed the entire capital and surplus of the U.S. property casualty insurance industry.***



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To further illustrate the problem, it may also be helpful to consider how much premium insurers are collecting on relevant commercial property insurance compared to the potential total BI losses from COVID-19. Total 2019 U.S. direct written premium for commercial property (Fire, Allied Lines, and Commercial Multiple Peril Non-Liability), which includes BI insurance among many other coverages, comes to an average premium of approximately $4.5 billion per month[vii]. The expected monthly small business loss scenarios presented above (from the lowest estimate of $52 billion to the highest estimate of $431 billion) are in the general range of 10 to 100 times the $4.5 billion average monthly premiums for the relevant commercial property lines. While premiums for BI insurance are not specifically reported, they represent only a fraction of the overall commercial property insurance premium and would be greatly dwarfed by the current business continuity losses.

<u>Insurers have a Role and are Responding</u>

Insurers do have a role to play in the current crisis, and in every region and state they are taking a variety of proactive and voluntary steps to help policyholders, employees, and communities in these extraordinary times. These steps include more than $14 billion in refunds and discounts for policyholders. Several insurance companies have also made substantial philanthropic commitments. Extraordinary insurer relief for consumers has included:

Assisting policyholders, communities, and businesses by:

- Offering flexible payment solutions for families, individuals, and businesses—providing additional time to make payments.
- Suspending premium billing for small business policyholders such as restaurants and bars, for a specific number of days or billing cycles.
- Waiving insurance premium late fees for families, individuals, and businesses.
- Working with commercial businesses to provide premium relief for policyholders where risk has been reduced in the current environment.
- Pausing cancellation of coverage for personal and commercial lines due to non-payment and policy expiration, which includes personal auto, commercial auto, homeowners, business owners, renters, boat, motorcycle, condominium, mobile home, personal umbrella, and landlord.
- Considering a covered premise as “occupied” while mandatory closures are in effect, addressing vacancy clause concerns.

Assisting auto policyholders by:

- Issuing refunds and discounts to drivers logging fewer miles during shelter-in-place orders.
- Suspending personal auto exclusions for restaurant employees transitioning to meal delivery services using their personal auto policy as coverage.

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Assisting first responders and nonprofit organizations by:

- Donating resources and funds to first responder funds, and other specific COVID-19 response funds.
- Providing wage replacement benefits for first responders and medical personnel who are quarantined.
- Donating specific items to medical organizations in need such as face masks, hand sanitizer, and disinfecting wipes.
- Committing time and foundation resources to nonprofit organizations, including Meals on Wheels, United Way, community health organizations, and other front-line organizations.

Assisting individuals, businesses, and communities in preparing for and recovering from catastrophes by:

- Adopting new technologies and remote solutions to minimize any interruptions in service, collision repair, and claims handling, such as using virtual inspection technology to complete damage inspections.
- Utilizing a variety of technology and virtual self-services, while adhering to safe social distancing protocols.
- Using advanced technology to better serve customers and increase the speed with which claims are processed.
- Utilizing innovative technology, like drones, that enables insurers to view damaged property remotely.
- Using a specialized 3D modeling app to render an accurate 3D model of homes.
- Implementing new technology to capture geo-coded, high-resolution aerial imagery hours after a catastrophic event to assess damages to property so that the policyholder's claim can be accurately adjusted.
- Adding more online account and claims services for policyholders.
- Providing links to customers via email or text for simple, one-touch claims and offering real-time video collaboration for more complex claims.
- Shifting more resources to anti-fraud and cyber security units, in recognition of the bad actors who will prey on victims during times of crisis.

In addition to the record payments insurers are expected to make to our policyholders as a result of COVID-19, the property casualty industry also is working closely with Congress and the Administration to provide federal relief to states and local business with hundreds of billions of dollars in additional targeted grants to impaired sectors, as well as to establish a prospective protection program for business continuity funding before a potential COVID-19 recurrence this fall or other widespread viral outbreaks in future years.

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Sincerely,

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[i] Estimate by Robert P. Hartwig, PhD, CPCU, Clinical Associate Professor, Finance Department and Director, Center for Risk and Uncertainty Management, Darla Moore School of Business, University of South Carolina.
[ii] APCIA using published reports, including IMF, World Bank, Learnbonds.com; APCIA adjustment to 2020 USD.
[iii] International Monetary Fund (IMF) Chief Economist Gita Gopinath, "The Great Lockdown: Worst Economic Downturn Since the Great Depression", April 14, 2020.
[iv] APCIA estimates based on publicly available data sources, Bureau of Labor Statistics, Insurance Services Offices estimates (Verisk Analytics, Inc.), Houston Chronicle, and S&P Global Market Intelligence.
[v] IBNR Daily, April 17, 2020.
[vi] APCIA estimate at end of 2020 Q1 based on S&P Global Market Intelligence.
[vii] APCIA's calculation based on S&P Global Market Intelligence